
K-12 EDUCATION

Proposition 98

From 1999-00 through 2003-04, more than \$2.7 billion was added to the Proposition 98 funding level above what was required by the California Constitution. In retrospect, it is clear that this was funded mainly by increases in General Fund tax proceeds that were not sustainable. Although the Administration has a fundamental commitment to schools, it is clear that part of the structural budget problem the State faces is due to this increase in education spending beyond what the State could afford without cutting other programs. Under Proposition 98, such increases become part of the Constitutional minimum for all following years.

Given the size of the budget problem to be solved, significant reductions in many programs outside of K-14 education are included in the Governor's Budget. Recognizing the importance to the State of maintaining the level of support for schools, the Administration chooses not to reduce State funding for K-14 education. The formula for the Proposition 98 funding level requires overall funding to increase by growth in per capita personal income and numbers of students and additionally to grow by an amount, called a maintenance factor adjustment. For 2004-05, it is estimated that this formula would require an increase in K-14 funding of \$3 billion.

The Governor's Budget proposes that schools retain an increase of nearly \$1 billion in property taxes allocated to schools, but that no additional State funding be added this year. This will allow normal K-12 funding adjustments for both student growth and cost-of-living adjustments to be made. Additionally, \$200 million in funding deferred from the Community Colleges' base budget last year is reflected in the 2004-05 totals, and additional funding for growth and equalization is provided, increasing Community College's share of the Proposition 98 guarantee.

Rebasing for General Fund Contributions to Proposition 98

The Constitutional provisions added by Proposition 98 allow a temporary rebasing of the required appropriations, if a bill is enacted pursuant to a two-thirds vote of the Legislature. The Governor's Budget proposes that the level of Proposition 98 appropriations be rebased at a level approximately \$2 billion less than otherwise required for 2004-05. Additional program funding capacity of approximately \$700 million is available within the existing funding level, due to the expiration of programs and adjusting for one-time costs incurred in 2003-04.



Agreements to Restore Funding

This action will create an additional \$2 billion maintenance factor that is required to be restored to the Proposition 98 budget in future years. Based on current projections of future revenue growth and other economic factors, the additional maintenance factor could be restored to the guarantee over the next three years, with substantial growth averaging approximately \$730 million per year as the economy expands. These funding additions will be in addition to the adjustments for student enrollment and per capita personal income. Thus, the Administration projects that this rebasing of the guarantee will impact school funding for only four years.

The Administration agrees to make general purpose funding a priority for 2004-05 and following years by first funding growth and cost-of living adjustments within the increases provided by the Proposition 98 guarantee. The Administration joins with the education community in proposing that priorities for the future restoration of the maintenance factor should: (1) restore deficits in apportionments, including cost-of-living adjustments, that were made in 2003-04; (2) fund valid deferred mandate reimbursements; and (3) the remaining funds would be split between general purpose apportionments and other State funding priorities in a 75 to 25 ratio.

Retiring Old Debts

Additionally, appropriations estimated to be required for 2002-03 and 2003-04 above the current level of the budgets for those years are proposed to be deferred and repaid in a series of statutory appropriations beginning in 2006-07. This will retire the outstanding debts to the schools from 1995-96 and 1996-97 of \$250.8 million and the additional amounts estimated to be needed to meet

the guarantee for 2002-03 and 2003-04 of \$517.9 million and \$448.4 million respectively. Funds appropriated for settle-up will be designated for one-time expenses such as instructional materials, training, and deferred maintenance.

K-12 Education Funding Reforms

Parents, students, school administrators, teachers, State and local auditors, Legislators, news reports, and other representatives of the public have raised numerous concerns with education funding in California over the years. Concerns include, but are not limited to:

- Too much of the funding is restricted to specific purposes.
- The focus is on implementing and accounting for programs—not results.
- Funding allocations are overly complex and do not appear fair.
- Parents, teachers, principals, and community members do not have effective input into academic program nor resource allocation decisions.
- Funding intended to help students with special needs may not be reaching the students or be spent effectively.

The Administration is interested in pursuing comprehensive reform of education finance. The proposals provide increased Flexibility, Accountability, Innovation and Responsibility (FAIR). The Governor's Budget reflects several proposals to make this FAIR start on education reform including:

- The shift of \$2 billion from 22 specified categorical programs to the revenue limits of the districts and county offices currently receiving the funds. Districts

will be free to continue the existing programs or shift funds to other uses, including innovative local programs. The programs being shifted currently provide money with fewer restrictions, are generally not targeted at special needs students, most districts receive funding from them and have historically stable allocations per district. Programs being retained as categorical funding are those that are earned by providing special services, such as vocational education; are legally mandated; are state-level services; are targeted to help special needs students; or are not exclusively school-based, such as child care.

■ Additional accountability measures accompany this funding, including:

- Improved access to information and opportunities for school principals, parents, teachers, and community members to have input on school budget decisions.
- State interventions in districts that consistently fail to meet academic growth targets.

- Restrictions on compensation for administrators of failing districts.
- Enhanced budget review by county offices.
- Requirements to provide standards-aligned instructional materials and adequately maintain facilities.

- \$110 million for equalizing base revenue limit funding.

K-12 Overview

Despite the fiscal challenge facing California, the K-12 education budget preserves core instructional programs through an increase of \$1.875 billion in total revenues to public schools. California's public schools continue to receive the resources to provide more than 6.2 million pupils a high-quality education and the tools to meet California's world-class standards.

As indicated in Figure K12-1, approximately \$58.1 billion will be devoted to California's 983 school districts and 58 county offices of education, resulting in estimated total per-pupil expenditures from all sources of \$9,398 in

FIGURE K12-1

Total Revenue for K-12 Education 2004-05 Governor's Budget

(Dollars in Millions)

	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	Change
K-12 Education¹										
General Fund	19,743,400	21,880,100	23,277,500	27,277,900	29,396,400	29,572,600	28,788,400	29,556,900	30,357,400	2.7%
Local Property Taxes	8,584,400	9,138,200	9,545,000	10,200,500	11,094,000	12,005,500	12,991,500	13,885,000	14,923,600	7.5%
Lottery	611,000	675,200	727,800	769,500	902,000	853,900	806,500	793,400	793,400	0.0%
Other State Funds	58,900	89,000	74,400	64,500	140,800	145,900	99,100	90,100	85,900	-4.7%
State School Fund (NonAdd)	(8,238)	(8,200)	(4,830)	(1,789)	(9,884)	(-3,008)	(-3,008)	(-3,008)	(-3,008)	0.0%
Federal Funds	2,990,800	3,472,700	3,858,800	4,438,900	5,005,300	5,442,600	6,390,700	7,118,800	7,159,500	0.6%
Local Debt Serv Taxes	425,800	498,300	611,700	706,700	827,800	1,012,900	1,195,500	1,195,500	1,195,500	0.0%
Local Miscellaneous	2,195,100	2,595,100	2,842,500	3,219,400	3,715,800	3,543,100	3,543,100	3,543,100	3,543,100	0.0%
'Total' Funds	34,609,400	38,348,600	40,937,700	46,677,400	51,082,100	52,576,500	53,814,800	56,182,800	58,058,400	3.3%

¹ 2002-03, 2003-04 and 2004-05 are estimated.



FIGURE K12-2

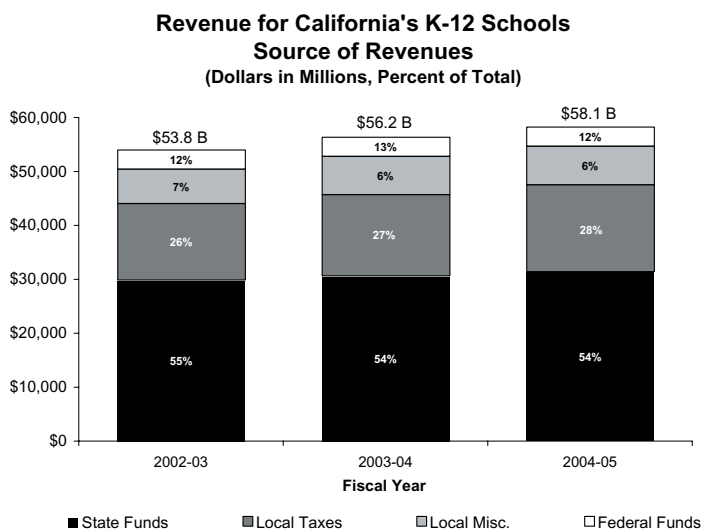
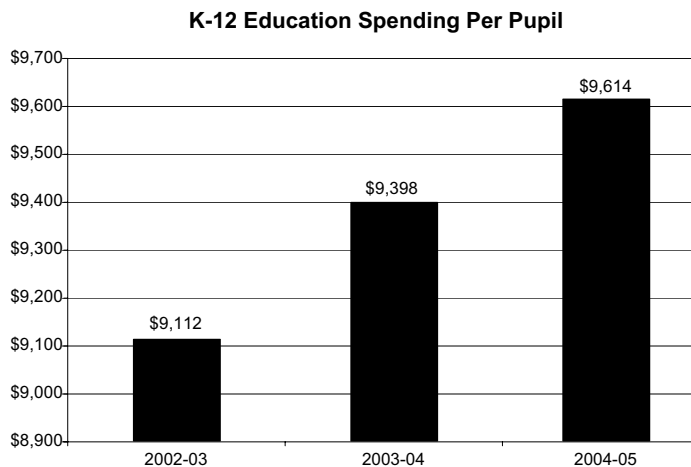


FIGURE K12-3



fiscal year 2003-04 and \$9,614 in fiscal year 2004-05 (see Figure K12-3). Figure K12-2 displays the various sources of revenues for schools.

Total 2004-05 Proposition 98 support for K-12 education will increase 1.1 percent over the 2003 Budget Act level, as adjusted for changes in local revenues and average daily attendance growth. This level of funding supports K-12 Proposition 98 per-pupil expenditures of \$6,945 in 2004-05, up from \$6,588 in 2002-03 and \$6,940 in 2003-04.

Funding reported by schools from their general funds and the various categories of expenditure, along with respective shares of total funding for each category, are displayed in Figure K12-4. All costs shown are those reported to the State by schools using the definitions specified in the California School Accounting Manual.

Proposition 98 Guarantee—Total 2002-03 Proposition 98 funding is \$43.6 billion, of which the General Fund share is \$28.8 billion. Because State tax revenues were higher than they were estimated to be last year, this funding level is currently estimated to be \$517.8 million below the revised constitutional minimum guarantee. Total 2003-04 Proposition 98 funding is \$45.9 billion, of which the General Fund share is \$30.2 billion. This funding level is currently estimated to be \$448.4 million below the updated constitutional minimum guarantee, again because of increased revenue estimates. These funding levels have been adjusted for changes in attendance and costs of apportionments programs, and no discretionary reductions to program levels are proposed. The estimated level of the guarantee has also increased since enactment of the 2003 Budget Act due to a shift of costs from 2003-04 to 2004-05 resulting from an increase in the deferral amount of the second principal apportionment.

Total 2004-05 Proposition 98 funding is proposed at \$46.7 billion, an increase of \$769 million over the revised 2003 guarantee. This level is \$2 billion less than the current estimate of the Proposition 98 guarantee for 2004-05. The Governor's Budget reflects a proposal to set this lower level of funding pursuant to legislation that would add this amount to the maintenance factor that is owed to schools in future years.

Property taxes are reduced \$1.3 billion to reflect the transfer of property taxes to local governments to offset sales taxes redirected to pay the debt service on the State's deficit reduction bonds. Property taxes are increased by \$1.3 billion by increasing city and county contributions to the Education Revenue Augmentation Fund as a substitute mechanism to sustain the level of Vehicle License Fee offset in 2003-04.

The General Fund comprises approximately 63.7 percent, or \$29.7 billion, of total proposed Proposition 98 funding (see Figure K12-5).

Deferred Appropriations—The budgets for the last several years have included savings generated by deferring appropriations from one year to the next. In 2003-04, a net amount of \$609.7 million in deferrals was made current. This one-time cost in 2003-04 results in fiscal capacity for program spending in 2004-05. The Governor's Budget reflects an ongoing level of deferrals of \$1.2 billion for K-12 education.

FIGURE K12-5

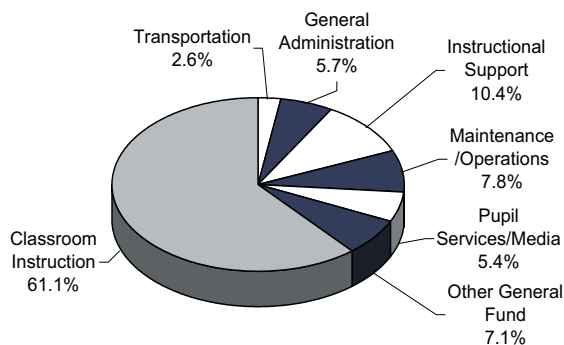
Proposition 98 (Dollars in Thousands)			
Proposition 98 Appropriation	2002-03	2003-04	2004-05
State General Fund	\$28,842,957	\$30,166,130	\$29,739,800
Local Revenue	14,780,926	15,778,671	16,973,852
Total	\$43,623,883	\$45,944,801	\$46,713,652
Total State and Local Distribution			
Department of Education	\$38,891,843	\$41,480,820	\$41,937,017
California Community Colleges	4,623,085	4,358,857	4,678,804
Department of Developmental Services	11,624	10,863	10,758
Department of Mental Health	17,851	13,400	8,400
Department of Youth Authority	37,685	36,781	34,041
State Special Schools	38,017	40,302	40,302
Indian Education Centers	3,778	3,778	4,330
Total	\$43,623,883	\$45,944,801	\$46,713,652
Proposition 98 Appropriations			
Percentage Share of General Fund	44.1%	43.5%	40.4%
SAL ^{1/} Revenues and Transfers			

^{1/} State Appropriations Limit, Article XIII B.

K-12 per pupil funding rises more slowly in 2004-05 due, in part, to the need to fund a \$200 million increase in California Community Colleges (CCC) spending levels as a result of a 2003-04 deferral.

FIGURE K12-4

Where Schools Spend Their Money



Classroom Instruction includes: general education, special education, and special projects.

General Administration includes: superintendent and board, district administration, other administration, centralized EDP, and maintenance and operations for administration.

Instructional Support includes: instructional administration, school site administration, and special projects administration.

Maintenance and Operations includes: utilities, janitorial and groundskeeping staff, and routine repair and maintenance.

Pupil Services includes: counselors, school psychologists, nurses, child welfare, and attendance staff. Media includes libraries and media centers.

Other General Fund includes: spending for tuition, facilities, contracts with other agencies, and transfers to and from other district funds.

(Based on 2001-02 data reported by schools.)

Child Care—Reflecting the Administration's view that children are a priority investment and that the lowest income families should be supported in their work participation and personal responsibility efforts, the Governor's Budget provides a total of approximately \$3 billion for the various child care programs administered by the State Department of Education (SDE), the Department of Social Services (DSS), and the CCC. These reflect savings of \$164.8 million from proposed reforms, expenditures, as well as caseload changes, the back-fill of one-time funding used in prior years, and provision of statu-



tory growth and cost-of-living adjustments (COLA) to non-caseload driven programs.

Functions of State Child Care Programs—

Subsidized child care services help low-income working families increase self sufficiency, contribute to school readiness of younger children, and support work participation of CalWORKs families through a variety of programs including voucher programs where parents pick the provider of choice, direct contract center based programs, State Preschool program, grants for Before and Afterschool programs, various programs for special populations, and a variety of programs designed to enhance the accessibility and quality of California's child care system. Programs specifically designed for CalWORKs families include Stage 1 administered by the DSS and Stages 2 and 3 administered by SDE. Services in Stages 1 and 2 are entitlement programs available to CalWORKs families for up to two years after they leave cash assistance. CalWORKs Stage 3 is not an entitlement program, but rather a discretionary program to continue

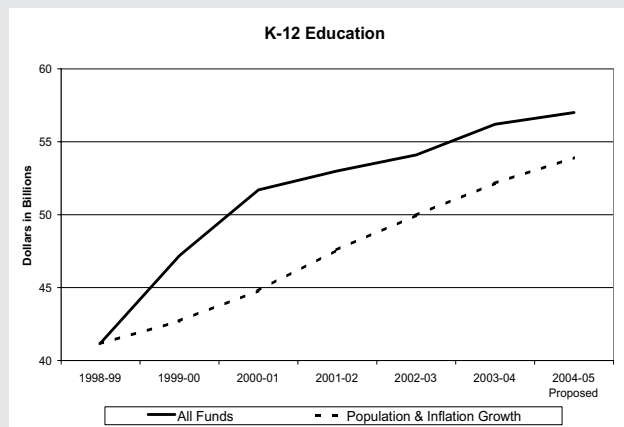
assistance to families after the entitlement ends if funding is available.

Improving Accountability and Service Delivery

School-Site Budgeting—An important core principle of the Administration's education policy is local control. This principle is a key reason why the Administration is increasing general purpose funding at the district level by fully funding growth and COLA, funding equalization, and shifting \$2 billion from categorical funding into revenue limits. While recognizing the responsibilities of school boards and district administrators, the Administration would like to foster increased control of resources at the school-site level. While no comprehensive proposal is being offered at this time, the Administration will be developing options for putting more control of school resources into the hands of parents, principals, and teachers at each school. Legislation accompanying the shift of categorical funding to revenue limits will call for more sunshine on local budgets and more

Key Audit Findings

- Total K-12 funding increased by \$14.8 billion, 36.1 percent, from 1998-99 to 2003-04.
- Discretionary increases in Proposition 98 expenditures in 1999-00 and 2000-01 added \$2.7 billion to the ongoing level of the minimum guarantee.
- Total annual General Fund program support for Child Care increased 52.7 percent between 1998-99 and 2003-04 primarily driven by a \$313 million increase for CalWORKs Stage 3, a \$162 million increase for State Preschool, and a \$71 million increase for Before and Afterschool programs.



opportunities for community and school-site participation in academic and budget decisions.

School District Academic Accountability—

The federal No Child Left Behind (NCLB) Act of 2001 includes a district level accountability system. However, this system is structured in a manner that is expected to result in interventions or sanctions for most, if not all, of the districts in the State. Therefore, the existing NCLB accountability system does not differentiate well between failing and improving districts and does not focus on the lowest-performing districts. Although individual schools have participated voluntarily in the State's accountability programs and are subject to State interventions and sanctions if they do not improve, there is no such State program for districts as a whole.

In conjunction with the movement towards providing districts more flexible funding, the Administration proposes to fill this gap in the State's accountability system by creating a set of district academic performance targets using the existing State testing system and the Academic Performance Index and applying it to all districts. The lowest performing districts that consistently fail to improve their schools' academic performance would be subject to the same types of State interventions and sanctions that individual schools are subject to under the existing school accountability programs.

Child Care Fraud and Compliance—

Child care fraud may cost the State well over \$100 million, assuming a 10 percent rate of fraud in alternative payment (AP) programs. These programs administer monthly payments to providers selected by the families in voucher programs. Documentation from counties like San Diego and Fresno that actively investigate child care fraud estimate the rate of fraud may range

from 30 percent to 40 percent. Other anecdotal evidence attests to specific instances of fraud, such as situations where parents claim child care costs for days and hours while they are not working, or collude with a provider to certify care that never takes place. A recent report by the SDE on fee and eligibility compliance requirements found that only 47 percent to 59 percent of contracting agencies are in compliance in these areas. These funds could be redirected to provide child care to others currently not receiving it or to reduce program costs.

The Governor's Budget proposes an augmentation of \$2 million in one-time federal funds for administrative start-up costs for a comprehensive anti-fraud proposal that is under development by the Administration. The Administration intends to work with the SDE to develop a legislative proposal by the 2004 May Revision. Implementation costs will be refined and appropriate adjustments to the Governor's Budget will be addressed at that time.

Major features of this proposal would likely clarify and define fraud; explicitly authorize its investigation and prosecution; establish criminal and/or administrative sanctions; require APs to collect overpayments; establish and standardize disqualification periods for persons and providers depending on the number and value of offense; establish fines; expand the scope of financial and compliance audits of direct service contractors and APs; and provide financial incentives for counties and APs to pursue fraud, perhaps allowing them to retain some portion of recovered funds (similar to Food Stamp and CalWORKs programs).

Child Care Reform—

According to a report released by the State and Consumer Services Agency in May 2001, California has the most generous eligibil-



ity, subsidy, and co-payment policies of any other large state. Modest changes included in the 2003 Budget Act have not materially changed this conclusion. Given the State's current fiscal situation, the Governor's Budget includes various reforms that are estimated to save the State \$164.8 million in 2004-05, assuming a 90-day implementation lag for required notice to families. Of this amount, \$123 million of the estimated savings are in programs administered by the State Department of Education and \$41.8 million of the savings are in Stage 1 administered by the Department of Social Services. Specific savings by program are as follows:

- \$41.8 million for Stage 1
- \$53.8 million for Stage 2
- \$32.5 million for Stage 3
- \$17.1 million for General Child Care
- \$16.3 million for the Alternative Payment Program
- \$3.3 million for the Latchkey program

The following principle policy goals are achieved through this proposal:

- Personal responsibility is promoted by lowering the income threshold when families are asked to share in the cost of child care. Gradual fee increases are proposed to prepare families for when they are no longer eligible for subsidies. Making families directly responsible for payments to providers also promotes this goal while reducing administrative costs on voucher administering agencies.
- Work participation is promoted by ensuring that CalWORKs families who are not able to obtain a slot in the general child

care system receive child care subsidies while they remain on assistance and for three years after leaving cash aid.

- Program effectiveness and quality will be enhanced by providing financial incentives for licensed providers to integrate early childhood development education principles and become accredited. Similarly, for license exempt providers, incentives are provided for health and safety training and use of early childhood development principles.
- Program equity is enhanced by implementing a tiered income eligibility structure that recognizes higher cost areas, by authorizing CalWORKs families to enter waiting lists for non-time limited general child care programs as soon as they begin earning income, by standardizing state policy on length of time a family can access subsidies for purposes of education and training, and by limiting subsidies for older children who have access to after school programs.
- Program integrity and efficiency will be enhanced by establishing lower reimbursement limits for lower quality care, improving compliance and actively pursuing fraudulent practices, and authorizing administrators to pursue overpayments made to providers and families through the offsetting of future payments.

Specific policy reforms include the following significant changes:

Child Care Family Fees—No large state begins family contributions at income levels as high as California does, nor do they provide child care subsidies up to California's current income ceiling. Personal responsibility is promoted by lowering the income threshold when families are asked to share in the

cost of child care. Gradual fee increases also prepare families for when they are no longer eligible for subsidies.

- A reduction is proposed in the fee-payment threshold, from 50 percent of the state median income (SMI) as adjusted for family size, to approximately 40 percent of the SMI, the level at which a family exits cash aid. Through gradual increases based on family income, fees would not exceed 10 percent of income as suggested in federal guidelines.
- It is proposed that the current fee exemption for Child Protective Services (CPS)-referred families be limited to one year. If a family were referred by a non-CPS professional, the fee exemption would be limited to a three-month respite period. A CPS referral would be required for any further service or extension of the exemption. No fee exemption would apply after the initial CPS referral period. These limits reasonably maintain protections for children while limiting State costs and encouraging timely resolution of CPS placement decisions.
- It is proposed that family fees be paid directly to the provider of the service. This would standardize practices among agencies that administer vouchers, saving administrative effort and further promoting personal responsibility.

Child Care Eligibility—As indicated above, most large states assess higher family fees and do not provide eligibility for families at income levels as high as California does. Many states do, however, recognize cost-of-living differences in various regions for purposes of determining eligibility. Therefore:

- A three-tiered income eligibility structure for general child care programs is pro-

posed to better compensate for the high cost of housing in certain counties. Savings would accrue by reducing the current income eligibility maximum in lower cost counties as defined by the county divisions applicable to CalWORKs assistance grants. This will contribute to greater equity in the distribution of limited subsidies.

- Beginning in 2005-06, annual adjustments for changes in income eligibility would be based on the California Necessities Index (CNI), a more stable index that better reflects the actual costs facing participating families.
- It is proposed that the need basis for child care related to education and training in SDE-administered programs all be limited to two years, consistent with the practice for CalWORKs programs. This will provide greater equity to families needing assistance to work.
- Additionally, services to 13 year olds would be permanently deleted, and services to 11 and 12 year olds would be continued only when local before and afterschool programs are not available.

Child Care Reimbursement Rate Limits—

California has the most generous policy of any other large state, allowing even license-exempt providers that do not serve private-pay clients to charge the State a rate equivalent to the 85th percentile of rates charged by licensed family day care homes competing in the market for unsubsidized families. No other state authorizes payments exceeding the 75th percentile of the market for licensed care, and many do not reimburse exempt providers at all.

Reforms to reimbursement rate limits are proposed to reduce documented excessive cost



practices and provide incentives to improve service quality. Therefore the Administration proposes that:

- Reimbursement rate limits would begin at the 40th percentile of the regional market (for license-exempt providers with no training) and would range up to the 85th percentile of the market for licensed providers serving unsubsidized families who can demonstrate the integration of early childhood development principles and have achieved accreditation. These sliding scales will provide incentives to providers to become licensed, improve the quality of child care, and provide a reasonable market-based reimbursement level tied to the quality of care when a provider serves only subsidized families.
- The SDE and DSS (which is the State's licensing entity) would develop a standardized process for determining quality of care for purposes of authorizing higher state reimbursement rate limits.

Time Limit Changes to CalWORKs

Stage 3—Current law entitles CalWORKs families to child care services for up to two years after they exit cash assistance in order to ensure successful transition to work and self sufficiency. Other low-income working families must apply to a waiting list for a slot to become available. Continuing Stage 3 for CalWORKs families proliferates an inequitable access policy based on cash assistance status and drives uncontrollable state costs. Therefore:

- It is proposed that all current and new CalWORKs families who have earned income from work be allowed to immediately compete on waiting lists for non-time limited general child care program slots with other working poor families.

- Further, all CalWORKs families would be assured of receiving services for up to three years after cash aid ends, instead of the continuous subsidy provided under current practice. This change effectively extends the entitlement for transitional care by a year.
- Any CalWORKs Stage 3 family who exceeds three years of transitional care in 2004-05 would be granted an extension of one additional year so that they will have time to make other arrangements, should they not be able to access a slot in the general child care programs.

State-Mandated Local Programs—The State Constitution and enabling statutes essentially require California to pay local government for the costs of State-required services, except in a few instances (such as when local government has a revenue source available to support the service, or if the related law creates a new crime or infraction, for example). Many bills have been passed in the expectation that little or no mandated costs would result, but after several years of legal process, a determination is made that very large reimbursements are owed, for several years in arrears as well as on an ongoing basis. The determinations made by the Commission on State Mandates (Commission) are often challenged in court and recent rulings have begun to limit previous Commission rulings that required reimbursement by the State.

State audits of specific education mandates have revealed a high rate of disallowable costs (as much as 100 percent in some instances) claimed by local agencies. Due to concerns about what the real liability of the State should be for mandates, as well as the fiscal condition of the State, all funding for mandates has been suspended or deferred.

It is clear that the state of mandate law has created a confusing, expensive process that is not resulting in either the expected reimbursement for local agencies nor informed fiscal choices for the Legislature and the Administration.

Potential State fiscal exposure in the education area alone is in the hundreds of millions of dollars (based on unaudited claims). Many claims for reimbursement have not been audited, so the State's true liability for mandates is not known.

The Administration plans to pursue legislation to reform and clarify mandate law in several areas:

- Clarifying that any State funding provided for a program through the Budget Act must be credited as an offset to any reimbursable costs, clarifying that the State may further limit the cost of mandates through budgetary controls.
- Requiring the Commission to submit recommended claiming rules, and an estimate of statewide fiscal impact of a mandate to the fiscal committees of the Legislature prior to formal adoption by the Commission, so that the Legislature can decide if the prospective reimbursable activities and costs match its intent when the legislation was enacted.
- Clarifying that only real additional costs are required to be reimbursed, eliminating reimbursement for the redirected time of existing employees and for the current level of effort for local entities that were already performing a subsequently mandated service. Reimbursement should be limited to the least costly approach—not whatever expensive method a local agency chooses to use. For instance, the state should not have to pay twice for school

janitors and supplies because it wishes to clarify that school bathrooms must be useable.

General Purpose Funding Complexities—

The Administration is concerned about the complex and cumbersome current system for allocating general purpose funds among school districts. The current system, which is largely built on historical practice, is unnecessarily complex and results in significant funding complications among school districts that are difficult for parents, teachers, principals, and the general public to understand and can result in disparate levels of state support between districts. The following examples illustrate some of these complexities:

- Base revenue limits, the main source of general purpose funding for schools, range from a low of approximately \$4,400 per pupil to a high of approximately \$8,300 per pupil, with an average of approximately \$4,800 per pupil. The Governor's Budget provides \$110 million in equalization funding as one method of partially addressing this disparity in base funding levels.
- Basic aid districts receive funding over and above their revenue limit because of their high property values. These excess taxes, which are not reflected in State funding calculations, have grown rapidly over recent years and provide these districts with extra general purpose funding that other districts do not receive. Basic aid districts average over \$6,000 per pupil in general purpose funding (with several districts exceeding \$15,000 per pupil), compared to the statewide average of approximately \$4,800 per pupil.
- The per-meal funding rates among districts receiving the meals for needy pupils revenue limit add-on vary from \$0.003 to



more than \$160 per meal served. Some districts previously had this add-on rolled into their base revenue limit, while other districts are frozen out of receiving funding for the program because they did not have a program when the add-on was established.

- The continuation high school revenue limit add-on results in significant per-pupil funding differences because the calculation is based on a foundation funding level that is not adjusted for changes in the number of pupils served in subsequent years.
- Current statutes provide certain districts with exceptions from standard funding guidelines for necessary small schools, interdistrict attendance, and other programs, while holding other schools to the normal requirements.

Recognizing that any attempt at comprehensive reform in this area will require the input of the many stakeholders and understanding that some differences in funding levels may be appropriate for valid policy reasons, the Administration will continue to review various options for improving the current system, with the goal of reaching consensus on a less complex and disparate approach.

School District Fiscal Accountability—

Recent years have seen a large increase in the number of local education agencies (LEAs) in fiscal distress. For example, at the 2002-03 second Interim Financial Reporting period there were 64 LEAs with qualified or negative certifications, up from 24 in 2000-01. In that time period, three districts had imbalances between revenues and expenditures so severe as to necessitate emergency loans and a State takeover of operations. In some of these instances, opportunities to correct problems early were not taken advantage of

and there was confusion surrounding local and State responsibilities for fiscally troubled districts. The Administration is concerned that cost pressures, local budget decisions, constraints on State education spending growth combined with the statutory requirement for LEAs to fully restore their reserves for economic uncertainty by the 2005-06 fiscal year may lead to continuing trouble at the local level.

Given the fiscal problems many districts face, the Administration believes that current laws and procedures regarding school district budget oversight require reform. The Administration intends to develop a process for early identification of fiscally troubled districts using warning signs to allow districts to invite experts to assist them in avoiding insolvency. After discussions with the Superintendent of Public Instruction, the Office of the Secretary for Education, the County Office Fiscal Crisis and Management Assistance Team (FCMAT), and other representatives of the K-12 community, the Administration proposes to improve the process and ensure greater fiscal stability among LEAs. Specific reforms the Administration supports would:

- Provide greater specificity for definitions of fiscal insolvency.
- Establish clear guidelines for making budget projections.
- Require all district collective bargaining agreements to be subject to a 15-day review and comment on budget impact by the County Superintendent of Schools before board adoption.
- Provide clear authority for the Superintendent of Public Instruction to assign FCMAT to districts in fiscal distress. Currently, only districts and the

County Superintendent of Schools have this authority to call upon FCMAT.

- Modify the process regarding emergency loans and State takeovers for troubled LEAs in order to incorporate lessons learned from prior experiences and to limit delays in the event an emergency loan is required in the future.

Further, to ensure that the proposed shift of categorical funds to revenue limits will be budgeted prudently, the Administration proposes that all districts must present an allocation plan to the public and their county superintendent of schools that allows them to fully restore their reserve for economic uncertainty by the 2005-06 fiscal year, as required by current statute.

Administrator Compensation—The District Superintendents in the nine largest school districts in California earn an average base salary of \$203,813 annually, with a high of \$250,000 and a low of \$147,400. The Superintendent of the Los Angeles Unified School District earns \$250,000 annually, and is eligible for a performance bonus of up to an additional \$100,000 annually, exceeding the salaries for the Los Angeles County Executive Officer (\$244,429), the Los Angeles City Manager (\$214,375), and the Los Angeles City Mayor (\$181,319). The Governor of the State of California's annual salary is \$175,000.

Additionally, some districts have established separate retirement systems for administrators, outside of the California Public Employees' Retirement System (CalPERS) and the Social Security system. The legality and potential future liability of these systems is questionable.

Senior administrators often negotiate severance pay packages that include 18 months of

salary. In a few unfortunate circumstances, districts were forced to make such payments to administrators that led the district into insolvency.

While the Administration recognizes that a superintendent is an important position and recruiting top talent is difficult, these excessive compensation practices should be reformed.

Facilities Funding for Alternative Education Programs—The Administration is concerned about questionable State policies that authorize State School Facilities Program (SFP) funding for continuation high schools, community day schools, and county community schools that came to light during a recent review of a related matter.

The SFP provides State funding for the new construction and modernization of K-12 public school facilities in California. While funding is generally provided as matching funds on a per-pupil basis, small schools and alternative education schools (continuation high, community day, and county community schools) utilize a more favorable funding methodology, which is intended to recognize that certain economies-of-scale that can be achieved in larger schools cannot be achieved in small schools. Since county offices of education (COEs) cannot create bond indebtedness, they are considered eligible for "financial hardship," thus qualifying for full State funding under the SFP. Meanwhile, current revenue limits for community day and county community schools include allowances for the lease or rent of facilities.

While the Administration recognizes that many alternative schools may have facility needs, the current school facility funding policies for these schools likely result in excess State costs and are in need of significant reform. Principal concerns include:



- The methods for determining eligibility under the SFP for county office of education programs are questionable given that county court schools are the only required programs for COEs.
- County community and community day schools are permissive and may exist to the extent local school districts elect not to operate alternate education schools to meet the needs of their student enrollment. Therefore, it appears that it may be more appropriate for local school districts to provide the local match in these circumstances.
- Many students do not attend classes for the full school day and the length of alternative classroom instructional delivery can vary greatly from school to school. However, current allocation practices do not recognize these variances, which may result in significant underutilization of classroom facilities.
- As noted, in some cases, alternative school revenue limits were built with the assumption that facilities would be leased. Therefore, it is inappropriate for the State to build facilities without reducing the revenue limit funding per student.

The Administration intends to conduct a thorough review of this matter and will propose new policies that address these concerns.

Program Enhancements and Other Budget Adjustments

Average Daily Attendance Growth—

Attendance growth in public schools continues to be relatively low, primarily due to steady declines in birth rates beginning in the early 1990s. For the current year, total K-12 ADA is estimated to be 5,978,127.

This reflects an increase of 72,412 ADA, or 1.23 percent, over the 2002-03 fiscal year and is 12,368 lower than the 2003-04 May Revision estimate. For the budget year, total K-12 ADA is estimated to be 6,039,207. This reflects ADA growth of 61,080 or 1.02 percent, over the current year.

2003-04 Apportionment Adjustments—

The Governor's Budget reflects an increase of \$294.4 million for revised estimates related to district and county office revenue limit apportionments. This amount reflects General Fund cost increases of \$261.4 million due to a higher-than-anticipated June principal apportionment deferral and \$53.7 million due to local property tax adjustments, which are offset by a decreased growth estimate of \$20.7 million reflecting adjustments for revised ADA growth, CalPERS offset and unemployment insurance estimates.

2004-05 Apportionments—The Governor's Budget reflects an overall increase of \$2.8 billion in revenue limit funding, with major initiatives including a shift of over \$2 billion from categorical funding and \$110 million for equalization.

Apportionment Growth—The Governor's Budget fully funds statutory enrollment growth for school district (\$264.8 million) and county office of education (\$15 million) revenue limit apportionments, and special education (\$37.4 million). This reflects the Administration's goal of preserving core K-12 services even in the midst of the current budget shortfall.

California Public Employee's Retirement System—

The Governor's Budget fully funds an estimated \$106 million increase in the CalPERS school employer contribution rate. Failure to fund this increase would effectively reduce existing budgets for school districts and county offices of education.

Unemployment Insurance—The Governor's Budget fully funds an estimated \$136 million increase in local education agency Unemployment Insurance (UI) reimbursements. This increase is attributable to a more than doubling of the UI rate, due to increased benefit amounts and longer eligibility periods coupled with local staffing reductions.

Cost of Living Adjustment—The Governor's Budget fully funds an estimated \$554.8 million statutory COLA increase (1.84 percent) for school district and county office of education revenue limit apportionments.

Categorical Programs Growth and COLA—The Governor's Budget provides \$89 million for statutory growth adjustments and \$115 million for COLA adjustments for categorical programs, including Regional Occupational Centers and Programs and Adult Education.

Equalization—The Governor's Budget provides nearly \$110 million for school district revenue limit equalization to address the disparity in base general-purpose funding levels. This equalization adjustment will apply to the revenue limits in place prior to the proposed shift of categorical funding.

Child Care Statutory Growth and Cost of Living Adjustments—\$27.5 million from Proposition 98 General Fund is provided for non-caseload driven programs (\$15.5 million for growth and \$22 million for COLA). Current statute provides for growth funding based on the change in the under four years of age population. The most recent demographic projection indicates population in that age group has increased 1.35 percent.

Charter Schools—In order to provide charter schools with more funding predictability and programmatic flexibility, the Governor's

Budget shifts charter school categorical block grant funds to charter school general purpose entitlements (\$21.9 million) and the Economic Impact Aid program (\$14.5 million). To mirror the per-student funding for the programs in the Charter Categorical Block Grant that are shifted to general purpose funding for districts, an increase of \$24.5 million in total funding is provided for charters in addition to the shifted funds. The Economic Impact Aid portion of the former charter school categorical block grant is added to the Economic Impact Aid program item, with a distinct allocation for charter schools.

Deferred Maintenance—The Governor's Budget fully funds the State Deferred Maintenance Program at \$250.3 million, an increase of \$173.3 million to the funding level provided in the 2003 Budget Act.

Instructional Materials—An augmentation of \$185 million is provided to restore funding for the Instructional Materials Block Grant to an amount closer to the level intended to provide for purchase of the 2002 English Language Arts adoption and to provide funding as an incentive to purchase the 2005 History and Social Science adoption. These additional funds are intended to remain as a separate categorical program to provide incentives for early purchase of newly adopted standards-aligned materials. The existing funding of \$175 million will be shifted to revenue limits.

Internet Access—\$20.2 million is provided to county offices of education to provide high-speed internet access for schools.

K-12 Categorical Funding—In order to streamline school funding and increase local flexibility, the Administration proposed reducing the number of State funded categoricals from 88 to 49 programs (including three consolidated programs). The Governor's



Budget provides \$9.5 billion for the remaining programs. Programs retaining separate funding include specific programs for services including class size reduction, child care and nutrition, services to special education and other programs that serve students with special needs, statewide accountability, legal requirements, targeted programs with earned ADA, programs being phased out, statewide services and oversight, and programs not supported by Proposition 98. The Governor's Budget proposes a shift of \$2 billion from 22 categorical programs to revenue limits for LEAs, including charter schools, currently receiving those funds. Funding is eliminated for seven smaller competitive grant programs, due to the sunset of the authorizing legislation or because they are proposed for suspension to provide more funding for general purposes. The funds shifted include any statutory growth and COLA adjustments for these programs.

The choices as to which programs to shift to revenue limits were based on a review of program allocation information by Administration Staff, and incorporated information provided in the recent Bureau of State Audits report on categorical funding. Programs were not evaluated on their merits. Programs were selected for inclusion in revenue limits include: programs where funding allocations to specific districts has been stable for several years, the programs currently do not require the funding to be earned by providing instruction to specific students, most districts get the funding, and there are few legal requirements or federal mandates to perform specific services. Specifically, the funding will be shifted from Home to School Transportation, School Improvement, Targeted Instructional Improvement Grants (for non-court ordered programs), Supplemental Grants, Instructional Materials, School Library

Materials, Staff Development Day Buyout, Beginning Teacher Support and Assessment, Intersegmental Staff Development, Bilingual Teacher Training, Mathematics and Reading Professional Development, Peer Assistance Review, Dropout Prevention, At-Risk Youth, Tenth Grade Counseling, English Learners Student Assistance, Year Round Schools, Specialized Secondary Program Grants, International Baccalaureate, Center for Civic Education, Pupil Residency Verification, and Teacher Dismissal Apportionments. The Administration proposes retaining these programs in the Education Code with the exception of specific funding requirements, which would be repealed. Thus allowing local education agencies to continue the program(s) or shift funds to a higher local priority.

Special Education—The Governor's Budget provides \$9.3 million in additional General Fund to provide adjustments under the special education formula, which includes increases of \$70 million for a 1.84 percent COLA, and \$37.4 million for growth. The Governor's Budget also reflects a local property tax increase of \$23.6 million and the use of an additional \$74.5 million in increased federal funds anticipated in the budget year as part of the statutory offset to the General Fund authorized by AB 602.

Principal Training—The Governor's Budget provides \$5 million for the fourth year of the Principal Training Program. This program will provide 15,000 principals and vice principals with training in instructional standards and effective school management techniques. Including the 2004-05 funding, sufficient funding will have been provided to train approximately 9,170 participants.

Pupil Testing—The Governor's Budget provides \$105.6 million, including federal funds, for various statewide exams. These

assessments provide valuable information to parents, teachers, schools, and the State regarding pupil performance, and are the foundation of the State's accountability system for both State and federal purposes. The assessments funded include:

- **Standardized Testing and Reporting (STAR) Exam**—\$65.5 million is provided for the STAR exam. This exam, which serves as the primary indicator for the Academic Performance Index, measures pupil performance on various State-adopted content standards, coupled with a national norm-referenced exam in grades 3 and 8.
- **High School Exit Exam (HSEE)**—\$21.2 million is provided for the HSEE. This exam helps to ensure that pupils who graduate from public high schools can demonstrate grade level competency in English-language arts, and mathematics. Under existing law, commencing with the Class of 2006, all pupils must pass the HSEE in order to receive a diploma. Funding includes \$498,000 for a study to determine the progress of middle schools and high schools in implementing instruction and curriculum aligned to those standards included on the HSEE, as well as \$2.5 million for workbooks that provide pupils and parents information regarding the exam.
- **California English Language Development Test (CELDT)**—\$18.8 million is provided for the CELDT. This exam is required for pupils whose primary language is not English in order to identify English language learners. This identification allows schools to better allocate resources to assist these pupils. In addition, schools are required to

annually assess English language learners to ensure that pupils who have attained proficiency in English do not continue to receive instruction using curriculum for English language learners. \$300,000 is included to create a vertical scale for the exam which would allow for a more accurate measure of school progress towards English proficiency for English Language Learners.

Accountability—The State has committed significant resources to improve the academic performance of low-performing schools. The need to continue this focus has not diminished. Therefore, the Governor's Budget continues to fund these programs:

- **Immediate Intervention/Underperforming Schools Program (II/USP)**—The Governor's Budget provides \$77.4 million, including federal funds, for the third year of implementation funding for schools that made significant progress but did not reach their growth targets, as well as schools in the Comprehensive School Demonstration Program. Additionally, the Governor's Budget includes \$32.7 million, including federal funds, for sanctions for those schools that failed to make significant progress during the two years they were provided with implementation funding.
- **High Priority Schools Grant Program**—The Governor's Budget includes \$208.6 million for the third year of funding for this program, including federal funds, which provides up to \$400 per pupil to the lowest-performing schools in the state to improve academic performance.

California School Information Services (CSIS)—The Governor's Budget includes \$4 million for technical support of participating districts, continued implementation



of Los Angeles Unified School District's CSIS-compatible student records system, and creation of unique identifiers for all California K-12 students in compliance with the No Child Left Behind Act.

Suspend Program Funding and Reflect Sunset Programs—\$32.6 million in savings will be achieved by eliminating funding for the following competitive grant programs: sunset Academic Improvement and Achievement Act (\$5 million), suspend Local Arts Education Partnership (\$6 million), suspend School to Career (\$1.7 million), suspend Healthy Start (\$2 million), sunset Charter School Facilities Grants (\$7.7 million), sunset Early intervention for School Success (\$2.2 million), and eliminate Teacher Credentialing-Pre-Internship (\$8 million). The funding provided by this is used to increase general purpose funding.

Educational Revenue Augmentation Fund (ERAF) Increase—During the State budget crises in 1992-93 and 1993-94, a series of measures were enacted requiring local governments (counties, cities, special districts, and redevelopment agencies) to shift a portion of the property taxes that they receive to the ERAF that was created in each county for allocation to school districts, county offices of education, and community college districts. Any property tax revenue growth from year to year is distributed among the local agencies and the county ERAF. Because the State uses the ERAF to support Proposition 98 requirements for schools and community colleges, any growth in the ERAF on an annual basis reduces the State's General Fund Proposition 98 obligation.

In 2003-04, local governments' vehicle license fee revenues were reduced by \$1.3 billion due to lag time necessary to implement higher fees when the offset was eliminated on June 20, 2003. Chapter 231, Statutes

of 2003, provided that this "gap" in funding would be repaid to local governments in 2006-07.

In response to the State's fiscal constraints, the Governor's Budget proposes to continue this gap level of reduction (\$1.3 billion) to local governments in the form of an increased ERAF shift beginning in 2004-05. Local governments would shift approximately \$1.3 billion of property tax revenues to the ERAF in order to decrease the State's General Fund Proposition 98 obligation. Details of the shift proposal will be forthcoming, but will adhere to the structure and methodology of the two prior shifts.

State Department of Education—SDE administers both State and federal education programs and operates the State Special Schools and Diagnostic Centers. The Governor's Budget provides \$112.8 million General Fund, \$172.1 million in other funds, and 2,487.6 personnel years for state operations in 2004-05. Significant federal funds increases include \$1.1 million in 2003-04 and \$688,000 in 2004-05 for work towards a longitudinal student database consistent with federal requirements; \$932,000 in 2003-04 and \$558,000 in 2004-05 for federal child nutrition reporting activities; and \$2 million in 2004-05 for child care fraud investigation.

Proposition 98 Reversion Account—One-time Proposition 98 Reversion Account uses totaling \$199.6 million are proposed as follows:

- \$98.1 million to restore the deferred funding for the Targeted Instructional Improvement Grant program to funding in the year districts incur the costs.
- \$46.3 million to partially restore deferred funding for the School Safety Program.

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- \$32.7 million to be reserved for court awards and settlements.
 - \$15 million toward Stage 3 Child Care funding needs.
 - \$6.7 million for a 2001-02 shortfall in funding for the K-3 Class Size Reduction Program.
 - \$652,000 for a shortfall in 2002-03 child nutrition funding.